The Commonwealth of Massachusetts

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

D.T.E. 04-62 December 9, 2004

Petition of Boston Gas Company, Colonial Gas Company, and Essex Gas Company, operating as KeySpan Energy Delivery New England, for approval of a consolidated Cost of Gas Adjustment Clause, a consolidated Local Distribution Adjustment Clause, a consolidated Distribution Terms and Conditions, and standardized rate tariff formats for all customer classes.

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I. INTRODUCTION

On June 18, 2004, Boston Gas Company ("Boston Gas"), Colonial Gas Company ("Colonial"), and Essex Gas Company ("Essex"), operating as KeySpan Energy Delivery New England ("KeySpan" or "Company"), filed a petition with the Department of Telecommunications and Energy ("Department") pursuant to 220 C.M.R. §§ 5.00 et seq. and 220 C.M.R. §§ 6.00 et seq. for approval of a consolidated Cost of Gas Adjustment Clause ("CGAC"), a consolidated Local Distribution Adjustment Clause ("LDAC"), consolidated Distribution Terms and Conditions, and standardized rate tariff formats for all customer classes. The Department docketed this matter as D.T.E. 04-62.

II. PROCEDURAL HISTORY

Pursuant to notice duly issued, the Department conducted a public hearing and procedural conference on July 13, 2004. The Attorney General of the Commonwealth of Massachusetts ("Attorney General") filed a notice of intervention as of right pursuant to G.L. c. 12, § 11E. The Department granted full intervenor status to the low-income weatherization and fuel assistance network, the Massachusetts Community Action Program Directors Association Inc., and the Massachusetts Energy Directors Association (together, the "Low-Income Parties"). The Department conducted an evidentiary hearing on August 26, 2004. The Company sponsored the testimony of Elizabeth Danehy Arangio, director of gas supply planning, and Ann E. Leary, manager of rates. KeySpan and the Attorney General each filed initial briefs on September 2, 2004, and reply briefs on

September 10, 2004. The evidentiary record includes 103 exhibits and seven responses to record requests.

III. STANDARD OF REVIEW

The regulations that govern the establishment and the application of the CGAC for local gas distribution companies ("LDCs") (220 C.M.R. §§ 6.00 et seq.) do not contain a standard for reviewing changes or modifications to the CGAC. Nor does Department case law contain a standard for reviewing changes or modifications to the LDAC. See, e.g., Bay State Gas Company, D.P.U. 95-104 (1995) (first "distribution adjustment clause" established for an LDC as part of a settlement, but no express standard stated for changes); Boston Gas Company, D.P.U. 96-50, at 171-173 (1996) (first LDAC established for an LDC; Department found an LDAC to be a rational approach to collect non-gas-related costs, but no express standard of review stated for changes).

Where statutes of general application allow for a broad range of regulatory discretion but do not speak in particularized terms to an instant case, the Supreme Judicial Court ("Court") has recognized that "the decision regarding what standard to apply is left to the [D]epartment's discretion." Wolf v. Department of Public Utilities, 407 Mass. 363, 370 (1990). In this case, we will apply that same discretion to our review of KeySpan's proposal concerning the CGAC and LDAC, which are administratively created rates.

Although the Company's proposal was not filed pursuant to G.L. c. 164, § 94 ("Section 94"),[1] we find it instructive to examine the standard of review applied under Section 94 in determining the appropriate standard of review for this case. The Department, after reviewing the propriety of rates under Section 94, sets rates that are "just and reasonable." Attorney General, et al. v. Department of Telecommunications and Energy, 438 Mass. 256, 264, n.13 (2002). This standard includes rates charged to customers under cost adjustment clauses. See Consumers Organization For Fair Energy Equality, Inc. v. Department of Public Utilities, 398 Mass. 599, 608 (1975). Although the fluctuations in cost adjustment clauses may not be subject to a rate proceeding under Section 94, the Department must scrutinize any proposed changes to the formulas of the cost adjustment clauses. Id. at 606. Accordingly, the Department will review KeySpan's proposal to determine whether the proposal results in just and reasonable rates for ratepayers.

Further, consistent with the approach taken by the Department under Section 94 as supported by the holdings of the Court, we will apply a public interest standard in our review of KeySpan's proposal. The public interest standard lies at the heart of Section 94 by judicial construction. Boston Edison Company/ComEnergy Merger, D.T.E. 99-19, at 8 (1999). The Court has construed Section 94 as requiring a public interest judgment by the Department in a number of cases: Massachusetts Oilheat Council v. Department of Public Utilities, 418 Mass. 798, 804 (1994); Boston Real Estate Board v. Department of Public Utilities, 334 Mass. 477,

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1 Under Section 94, the Department examines the propriety of new or changed rates and charges of an electric or gas company.

495 (1956); Massachusetts Institute of Technology v. Department of Public Utilities, 424 Mass. 856, 867 (1997); see also, Wolf at 369 ("the mission of the agency is to regulate in the public interest," citing Zachs v. Department of Public Utilities, 406 Mass. 217, 223-224 (1989)). Therefore, the Department finds it appropriate to examine KeySpan's proposal also to determine whether it is consistent with the public interest.[2]

IV. THE COMPANY'S PROPOSAL

A. Introduction

KeySpan has proposed to establish a consolidated Gas Adjustment Factor ("GAF") within the CGAC that allocates gas costs among Boston Gas, Colonial, and Essex customers who are served by the Company's consolidated resource portfolio (Exh. KED/EDA-1, at 3).[3] In addition, the Company has proposed to establish a simplified and uniform tariff structure that includes: (1) a consolidated Local Distribution Adjustment Factor ("LDAF") within the LDAC; (2) a consolidated Distribution Terms and Conditions ("Terms & Conditions"); and (3) standardized rate tariffs under a unified numbering system (id.). The initial consolidated GAF proposal includes: (1) consolidating the credits obtained for capacity releases and off-system sales, and consolidating supplier refunds relating to the transportation program; (2) using a new, standardized purchased gas working capital factor; (3) consolidating the

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2 In determining whether KeySpan's proposal is consistent with the public interest, we will balance the costs and benefits, under a "no net harm" standard rather than a "net benefit" test. See Boston Edison Company, D.P.U. 850, at 6-8 (1983).

3 As part of the proposed consolidated GAF, the existing class-specific GAFs for Essex will be eliminated (Exh. KED/AEL-6, at 2).

reconciliation of the over- under-recovery of gas costs in year two; (4) combining the calculation of gas acquisition, planning, and dispatch function costs ("gas acquisition costs")[4]; and (5) treating separately the calculation of bad debt expense. The Company's consolidated LDAF proposal includes: (1) wording revisions; (2) consolidating certain of the components of the LDAF; and (3) consolidating the reconciliation factors. The following sections describe the components of the Company's proposal.

B. Consolidated GAF

KeySpan stated that the GAF is designed to recover the costs that the Company incurs to purchase, store, transport and finance gas on behalf of customers (id. at 4). The primary components of the GAF are: (1) fixed demand charges associated with transportation and underground storage contracts that the Company holds to transport purchased gas to the Company's city gates[5], and to store gas purchased during the summer for use during the winter; (2) the cost of gas commodity purchases; (3) local production and storage costs; (4) working capital costs relating to the use of the Company's available funds to finance gas purchases; (5) gas acquisition cots; (6) inventory financing costs; (7) capacity credits; and (8) bad debt expense attributable to uncollectible gas costs (id. at 4-5).

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4 These are the test year level of Company operations and maintenance expenses associated with procuring and managing the resource portfolio.

5 A city gate is a point of interconnection between an interstate pipeline and an LDC's system where natural gas is delivered, and where ownership changes to the LDC.

KeySpan stated that, prior to the mergers[6], Boston Gas, Colonial, and Essex calculated their GAFs independently based on their respective, pre-existing and differing CGACs and historical portfolio costs incurred by each company as a stand-alone entity (Exhs. KED/AEL-1, at 5-6; KED/EDA-1, at 5-6). Specifically, each company summed the demand charges associated with the transportation and underground storage contracts held by the company as a stand-alone entity and charged them exclusively to the customers of the company through the GAF (Exh. KED/AEL-1, at 6). Similarly, each company summed the gas commodity costs and the local production and storage costs incurred by the company as a stand-alone entity and charged them exclusively to the customers of the company through the GAF (id.). KeySpan stated that because each LDC's gas commodity costs depended upon the type of resources held by the company as a stand-alone entity, the gas commodity costs for the three companies differed slightly depending on each company's resource mix and the pricing indices in place in the respective production and market areas from which the individual company obtained its gas supply (Exh. KED/EDA-1, at 6).

According to KeySpan, the method for calculating the GAFs for the three companies has remained unchanged since the mergers (Exh. KED/AEL-1, at 6). KeySpan stated that, following the mergers of Boston Gas with Colonial and Essex, the Company purchases gas supply for the three LDCs jointly, rather than on a stand-alone basis as before, in order to achieve operational efficiencies and cost savings that benefit all customers (Exhs. KED/AEL-1,

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6 The "merger" orders consist of: Eastern-Essex Acquisition, D.T.E. 98-27 (1998) and Eastern-Colonial Acquisition, D.T.E. 98-128 (1999).

at 6; KED/EDA-1, at 6-7). KeySpan stated that the Company has achieved savings in annual demand and commodity cost of approximately $12,201,000[7] as a result of combining the portfolios of the three companies (Exh. KED/EDA-1, at 20). On a company-specific basis, this annual savings in demand cost reductions in the GAF, compared to the stand-alone costs, consisted of approximately $3.2 million for Boston Gas customers, $4.5 million for Colonial customers, and $4.3 million for Essex customers (id. at 22). According to KeySpan, since the mergers, the total amount of demand costs saved have been approximately $12.8 million for Boston Gas customers, $18 million for Colonial customers, and $21.5 million for Essex customers, as a result of combining the portfolios of the three companies (id.).

KeySpan stated that the Company's resources now are used on the basis of price and operational efficiency without regard to the particular company that owns the contract entitlement to the resource (id. at 7-8). This means that the per-unit price of pipeline supplies, underground storage supplies, and peaking supplies is generally the same for each company (Exh. KED/AEL-1, at 6). For purposes of calculating the GAFs, however, KeySpan currently develops the commodity cost for each company by taking the system-wide commodity cost for each type of resource (i.e., pipeline supplies, underground storage, and peaking resources) and applying it to the contractual entitlements held in each company's name (id. at 6-7). If the individual company does not hold the contract entitlements equal to the amount of gas used to

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7 Demand cost savings of $12,062,000 and commodity cost savings of $139,000 (Exh. KED/EDA-6(a)).

meet the company's sendout requirements, KeySpan makes up for the difference by imputing a blended cost representing the mix of marginal resources available to the system (id. at 7).

The Company stated that, although the consolidation of its resource portfolio has been effective in meeting customer requirements and in reducing costs, these efforts have created a mismatch between (1) the costs recovered from customers through the GAF, which are based on which company owns the resource contracts and (2) the costs and benefits associated with the provision of gas service to all customers using the combined portfolio (Exh. KED/EDA-1 at 8, 16). According to the Company, because the current method for calculating the GAFs for Boston Gas, Colonial, and Essex neither includes the set of resources from which customers are taking service, nor includes the cost of capacity procured to meet system needs on a going forward basis, it is no longer appropriate to charge customers based solely on the identity of the company holding the resources (id. at 16).

To correct the mismatch between the actual cost incurred by KeySpan to serve the customers of Boston Gas, Colonial, and Essex and the total amount paid by the customers of each company for the use of the resources, the Company proposed to modify the way it calculates the GAFs for the three companies. Specifically, the Company proposed to pool the demand charges, local production and storage costs, and gas commodity costs associated with the consolidated portfolio and to establish a consolidated GAF for all KeySpan customers (id. at 8). KeySpan stated that the consolidated GAF would be calculated in the same way that the GAF for Boston Gas is currently calculated with the method applied on a system-wide basis

(Exh. KED/AEL-1, at 8).[8] According to KeySpan, the pooling of costs, as proposed, accurately represents the way that the Company's gas supply resources are managed to serve all customers (Exh. KED/EDA-1, at 8). Further, the proposed modification to the GAF calculation aligns resource use with cost recovery, and appropriately distributes the costs and benefits associated with the consolidated resource portfolio among all customers (id.).

KeySpan also proposed to consolidate the credits obtained for capacity releases and off-system sales, and supplier refunds relating to the transportation program for the three companies (id. at 9). In addition, the Company proposed to use a new, standardized working capital factor (equity and debt)[9] that will be applied to gas purchases on a system-wide basis (id. at 9). The Company stated that it would use the weighted cost of capital of 9.08 percent and the weighted cost of debt of 3.86 percent, approved for Boston Gas in its recent base-rate proceeding in Boston Gas Company, D.T.E. 03-40 (2003), in calculating the new working capital factor (Exh. KED/AEL-1, at 9).

According to KeySpan, the weighted cost of capital and the weighted cost of debt approved for Boston Gas in D.T.E. 03-40 are lower than the rates currently used in the CGAC filings for Colonial (10.24 percent and 4.85 percent, respectively) (id.). Also, Boston Gas's weighted cost of capital is lower and the weighted cost of debt is approximately the same as

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[8] The rates for Colonial would be converted from therms to ccfs for billing purposes (Exh. KED/AEL-1, at 8).

[9] The working capital factor is a function of purchased gas costs, and is calculated using the weighted cost of equity and the weighted cost of debt from each LDC's last base rate proceeding (Exh. KED/AEL-1, at 9).

the rates currently used in the CGAC filings for Essex (10.24 percent and 3.84 percent, respectively) (id.). KeySpan, thus, contended that the rates for Boston Gas appropriate to use in this proceeding (id.). KeySpan further stated that the weighted cost of capital and the weighted cost of debt approved for Boston Gas in D.T.E. 03-40 are representative of the Company's current capital structure and capital costs, while the Colonial and Essex capital structures and capital costs evidence conditions at the time of their last rate cases in 1993 and 1996, respectively (id.). KeySpan has proposed to base the calculation of the working capital factor on a net lag period of 35.20 days (Exh. DTE-1-43 (Att.)).[10] This figure represents the combined (average) net lag period for the three companies (id.; Tr. 32).

The Company proposed to consolidate the reconciliation of the under- or over-recovery of gas costs for the three companies, starting in year two following the consolidation of the GAF (Exh. KED/AEL-1, at 10). In year one, KeySpan will maintain individual reconciliation factors for Boston Gas, Colonial, and Essex to ensure the recovery of any pre-existing under-or over-collections (id.). However, if the Company determines at the end of the first year that the amount of pre-existing under or over-collections still outstanding is significant, then it will propose to continue the individual reconciliation factors for a second year (Exh. DTE-1-34).

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10 The net lag period is the period between the date when customers receive gas service and the date when they make payment to the utility. It is determined by the following: (1) days delay from gas service to customer meter reading; (2) days from meter reading to billing; (3) days delay from billing to bill collection; and (4) total days lag in payment of expense (Exh. DTE-1-43).

With regard to gas acquisition costs, the Company stated that those costs are currently recovered differently for Colonial and Essex (Exh. DTE-1-42). Colonial recovers its gas acquisition costs partly through the GAF and partly through base rates, while Essex recovers them through base rates (id.). For administrative efficiency and to simplify the calculation of the consolidated GAF, the Company is proposing to combine the gas acquisition costs for Essex customers and charge them to all customers on an equal per-unit basis (id.).[11] The Company, however, stated that it is not opposed to maintaining the existing reconciliation factor for each company with regard to gas acquisition costs under the consolidated GAF (id.).

KeySpan stated that it will not consolidate the calculation of bad debt expense until rates are consolidated across the Company's service territory, because bad debt expense is currently calculated and recovered differently in each service area (Exh. KED/AEL-1, at 10).[12] Also, the Company stated that it will retain the individual reconciliation adjustment factors for bad debt until any under- or over-collections of the bad debt component of the GAFs for the three companies are fully recovered (id.).

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11 The Company stated that gas acquisition costs on a combined basis equal $976,000, or just 0.1 percent of the total annual gas costs (Exh. DTE-1-42). Therefore, the inclusion of this cost would result in an annual per-unit factor of $0.0014 per therm, or an additional charge of $0.17 per month for a typical residential customer on the Essex system using 1,460 therms per year (Exh. DTE-1-42).

12 The Company stated that currently Boston Gas and Colonial recover the gas cost portion of bad debt expense through the CGAC and the base rate portion through base rate tariffs (Exh. DTE-1-35). Essex, on the other hand, does not recover any of its bad debt expense through the CGAC. It recovers all bad debt expense through base rate tariffs (Exh. DTE-1-35).

According to KeySpan, its CGAC filing, using the current method, made with the Department in September 2003 to be effective November 1, 2003 through October 31, 2004 ("November 2003 CGA filing"), resulted in a GAF of $0.7283 per therm for Boston Gas, $0.7129 per therm for Colonial, and $0.6537 per therm for Essex (id. at 10-11). Compared to the November 2003 CGAC filing, the consolidated annual GAF under the current proposal would have been $0.7168 per therm for each company (id. at 11).

In terms of bill impacts, the implementation of the consolidated GAF would result in a slight reduction in the monthly bills for all Boston Gas customers (i.e., less than one percent decrease in the peak season and approximately one percent decrease in the off-peak season) (id. at 12). For Colonial (Lowell Division) customers, the implementation of the consolidated GAF would increase customer bills by approximately one to two percent in the peak season, and decrease customer bills by approximately three to ten percent in the off-peak season (id.). For Colonial (Cape Cod Division) customers, the implementation of the consolidated GAF would increase customer bills by approximately one to three percent in the peak season and decrease customer bills by approximately three to ten percent in the off-peak season (id.).[13] For Essex residential, non-heating customers, the implementation of the consolidated GAF would result in bill impacts ranging from increases of approximately seven to 16 percent in the peak season and increases of approximately five to seven percent in the off-peak season (id.).

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13 KeySpan stated that part of the bill impact anticipated for Colonial customers stems from the transition of Colonial from a base/supplemental GAF calculation to peak/off-peak GAF calculation, which has the effect of collecting a greater amount of costs in the peak season than would have occurred in the past (Exh. KED/AEL-1, at 12).

The bill impacts for Essex residential heating customers would be an increase of approximately five to twelve percent in the peak season and one to three percent in the off-peak season (id. at 13). For Essex low-load factor commercial and industrial customers (G-41, G-42, and G-43), the implementation of the consolidated GAF would result in bill impacts ranging from an increase of approximately four to eight percent in the peak season and a decrease of approximately three percent to an increase of six percent in the off-peak season (id. at 14). For Essex high-load factor commercial and industrial customers (G-51, G-52, and G-53), the implementation of the consolidated GAF would result in bill impacts ranging from an increase of approximately 14 to 27 percent in the peak season and an increase of approximately four to seven percent in the off-peak season (id. at 14).

KeySpan stated that the relatively high bill impacts for Essex customers are a result of a number of factors (id. at 12-13). First, according to the Company, the resources currently held in the Essex portfolio are no longer sufficient to meet the sendout requirements of Essex customers (id. at 12-13). The Company stated that, as a result, the needs of Essex customers are being met, in part, by resources held in Boston Gas's portfolio (id.). The Company, however, added that under the current GAF structure, Essex customers are paying only for the costs associated with the resources held in the Essex portfolio (id.). The Company claimed that Essex customers are not bearing the full costs incurred to serve them, and are being subsidized by Boston Gas's customers (id.). Second, The Company stated that part of the bill impacts for Essex customers is the result of the elimination of the class-specific GAFs that are currently in place for Essex customers (id. at 13).[14]

C. Consolidated LDAC

KeySpan also proposed to consolidate the LDAC tariff for Boston Gas, Colonial, and Essex (id. at 17). The Company stated that the consolidated LDAC tariff will be based on the Boston Gas LDAC tariff, with certain changes made to the terms of the clause (id.). The Company stated that the changes will entail simple wording revisions to refine and update the tariff and incorporate specific terms needed to maintain certain pre-existing differences between the service areas, such as bad debt calculation (id.). To achieve uniformity across service areas and to simplify the calculation of the LDAF, KeySpan proposed to consolidate the following components of the LDAC: (1) demand-side management ("DSM") program costs; (2) transition costs ordered by the Federal Energy Regulatory Commission ("FERC"); (3) unbundling costs; (4) interruptible transportation margins; and (5) supplier imbalance penalties (id. at 17-18).

For DSM program costs, the Company will calculate a uniform factor that would be charged to all customers, instead of the current practice whereby costs are allocated among the three service areas based on the number of customers in each service area (id. 18). Under the Company's proposal, the FERC-ordered transition costs, interruptible transportation margins, and supplier imbalance penalties will apply across the entire combined resource portfolio (id.).

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14 According to the Company, the actual bill impacts resulting from the consolidated GAF will depend on the gas costs projected for the 2004-05 peak season (Exh. KED/AEL-1, at 11).

The Company also proposed to consolidate the individual reconciliation factors after year one following the LDAC consolidation, with the exception of company-specific reconciliations for those components not consolidated (id.). Specifically, KeySpan stated that the Company will not consolidate the following components of the LDAC: (1) environmental remediation costs; (2) lost base revenues/exogenous costs; and (3) pension and post-retirement benefits other than pensions ("PBOP") factors (id.).

The Company stated that the only difference between the existing LDAC tariffs and the proposed consolidated tariffs is that the Boston Gas formula, used in the consolidated LDAC tariff, includes a component for costs associated with pensions and PBOP, while the Colonial formula includes a component for lost margins, associated with past DSM programs, and one for exogenous costs as defined in Eastern-Colonial Acquisition, D.T.E. 98-128 (1999) (id. at 19). According to KeySpan, these differences will be maintained in the consolidated LDAC tariff (id. at 19).

D. Consolidated Distribution Terms and Conditions

KeySpan stated that because the Terms & Conditions were standardized on a state-wide basis in Gas Unbundling, D.T.E. 98-32 (1999), there is not much difference in the Terms & Conditions for the three companies (id. at 20). According to the Company, any differences that exist in the Terms & Conditions for Boston Gas, Colonial, and Essex will be incorporated into the consolidated Terms & Conditions for the KeySpan service area, with the Boston Gas Terms & Conditions serving as the starting point (id. at 20-21).

E. Standardized Rate Tariff Formats

According to KeySpan, the current rate tariffs for Boston Gas, Colonial, and Essex are in the same format as the tariffs in place prior to the mergers (id. at 19). The Company proposed to standardize the language, presentation, and numbering of rate tariffs for the three companies to the extent possible without making any substantive changes to the availability clauses or rate structures (id. at 19-20). KeySpan stated that it will adopt the rate tariff presentation previously used for Boston Gas as the standard format (id. at 20). For tariff numbering, KeySpan stated that the rate tariffs for the three companies will be numbered as follows: Boston Gas starting with 100, Essex starting with 200, Colonial (Lowell Division) starting with 300, and Colonial (Cape Cod Division) starting with 400 (id.).

The Company claimed that standardized rate tariff formats will facilitate transactions between the Company and customers, and between the Company and third-party marketers doing business in its service territory (id. at 15). The Company added that standardized rate tariff formats are a necessary step in the Company's ultimate goal of implementing fully consolidated rates for the KeySpan service territory (id.).

F. Mitigation Plan for Essex

In response to the Department's request at the hearing for KeySpan to consider a plan to mitigate the increase for Essex customers from the consolidated GAF, KeySpan submitted a plan to phase in the increase for Essex customers over a two-year period (RR-DTE-5). The Company stated that, to phase in the bill impact for Essex customers over two years, it will first calculate the difference between the consolidated GAF and the GAF that would become effective for Essex customers during the 2004-2005 peak period using Essex-only gas costs (id.). The Company will then divide the difference by two, and recover one-half of the amount from Essex customers, and the other half from Boston Gas and Colonial customers via their 2004-05 peak GAFs (id.). Beginning with the 2005-06 peak GAF, KeySpan will calculate the GAF for Essex based on the proposed GAF consolidation to bring Essex customers even with Boston Gas and Colonial customers (id.).

As a result of the proposed phase-in plan, the new bill impacts for the 2004-05 peak period for Essex residential non-heating customers (R1) show an increase of between 5.1 percent and 7.4 percent (id.). For Essex residential heating customers (R3), the new bill impacts show an increase of between 2.7 percent and 3.4 percent (id.).[15] The bill impacts for all other Essex residential customers show an increase of between 5.5 percent and 12.2 percent (id.). For Essex commercial and industrial customers, the bill impacts range from increases of 1.9 percent to 19.9 percent (id.).

Boston Gas residential heating customers (R3) will see a bill increase of between 3.8 percent to 4.3 percent for the 2004-05 peak period as a result of the Company's two-year phase-in proposal (id.). For Boston Gas residential non-heating customers (R1), the new bill impacts show an increase between 2.9 percent and 3.7 percent (id.). The bill impacts for all other Boston Gas residential customers show an increase of 4.0 percent to 5.2 percent (id.).

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15 According to KeySpan, the calculations of the new bill impacts include a separate calculation of gas acquisition costs for each company (RR-DTE-5) (see Section V.A.2, infra).

For Boston Gas commercial and industrial customers, the bill impacts range from an increase of 2.7 percent to an increase of 4.4 percent (id.).

The new bill impacts for Colonial (Cape Cod Division) residential heating customers (R3) range from an increase of 7.2 percent to an increase of 9.0 percent (id.). For Colonial (Cape Cod Division) non-heating residential customers (R1), the new bill impacts range from an increase of 4.5 percent to an increase of 5.9 percent (id.). The new bill impacts for all other Colonial (Cape Cod Division) residential customers range from an increase of 4.5 percent to increase of 10.6 percent (id.). The bills impacts for Colonial (Cape Cod Division) commercial and industrial customers will now range from an increase of 5.5 percent to an increase of 7.5 percent (id.).

Finally, the new bill impacts for Colonial (Lowell Division) residential heating customers (R3) for the 2004-05 peak period range from an increase of 7.8 percent to an increase of 8.5 percent (id.). For Colonial (Lowell Division) non-heating residential customers (R1), the new bill impacts range from an increase of 5.0 percent to an increase of 6.4 percent (id.). The bill impacts for all other Colonial (Lowell Division) residential customers now range from an increase of 6.5 percent to an increase of 9.9 percent (id.). The new bill impacts for Colonial (Lowell Division) commercial and industrial customers range from an increase of 7.8 percent to an increase of 9.2 percent (id.).

V. ISSUES

A. Gas Acquisition Costs

1. Positions of the Parties

a. Attorney General

The Attorney General claims that the Company's GAF consolidation proposal results in the double recovery of gas acquisition costs (Attorney General Brief at 4, citing Tr. at 20-21).[16] The Attorney General states that KeySpan charges all gas acquisition costs to Boston Gas, Colonial and Energy North according to allocation formulas approved by the Securities and Exchange Commission ("SEC") (id. at 4-5, citing Tr. at 26). The Attorney General also states that: (1) all of Essex's gas acquisition costs are included in the costs allocated to Boston Gas (id. at 5, citing Exh. AG-1-16; Tr. at 19-20); and (2) in Boston Gas's most recent rate case, Colonial's test year gas acquisition costs were reallocated to Boston Gas and subsequently included in Boston Gas's rates effective as of November 1, 2003 (id., citing D.T.E. 03-40, at 214).

The Attorney General notes that Essex is recovering gas acquisition costs through its base rates in the amount of at least $186,418 (id., citing Exh. AG-2-2). The Attorney General adds that Colonial is also recovering gas acquisition costs in the total amount of $985,818, half of which is being recovered through base rates and the other half through the CGAC (id.,

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16 The Attorney General notes that the Department does not allow a utility to recover costs twice (Attorney General Brief at 4, citing: Fitchburg Gas and Electric Light Company, D.T.E. 99-66-A (2001); Fitchburg Gas and Electric Light Company v. Department of Telecommunications and Energy, 440 Mass. 625 (2004); Wyman-Gordon Company, D.P.U. 1669-B (1987)).

citing Exh. AG-1-10). The Attorney General argues that, in effect, Boston Gas's "customers are currently being charged all [gas acquisition] costs incurred and Essex and Colonial customers are paying costs no longer incurred" (Attorney General Brief at 5). The Attorney General concludes that unless the total gas acquisition costs, both the amounts in Colonial's GAF and base rates as well as the amount in Essex's base rates, are removed from Boston Gas's costs, "there will be a double recovery of gas acquisition costs" (id. at 6).[17] In addition, the Attorney General asserts that the Company should refund the over-collection amount that has accumulated since the date Boston Gas's current base rates became effective, November 1, 2003 (id.).

The Attorney General further argues that, although the Company has indicated that it will consider treating gas acquisition costs as a cost category not subject to consolidation, the Company has not indicated that it will keep the reconciliation factors for gas acquisition costs separate for each company (Attorney General Reply Brief at 1). The Attorney General states that, although he does not advocate the Department's approving the Company's proposed consolidated CGAC, the Department should direct the Company to segregate the gas acquisition costs and the reconciliation factors for those costs if the Department approves the Company's proposal, as modified (id. at 2).

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[17] The Attorney General states that the Company's proposal may eliminate the over recovery of only a portion of the costs, the amount related to the costs flowing through the Colonial CGAC in the amount of $492,909 ($985,818 / 2) (Attorney General Brief at 5, citing Exhs. AG-1-4; AG-1-5).

b. The Company

The Company contends that the Attorney General's argument regarding double recovery of gas acquisition costs is flawed (Company Reply Brief at 3). The Company claims that the amounts charged to Boston Gas for gas acquisition costs, beginning November 2003, are the costs that Boston Gas would incur for those activities even in the absence of the mergers (id. at 3). The Company asserts that the Department's inclusion of gas acquisition costs in the base rates and CGAC in D.T.E. 03-40 resulted from the determination that these costs were not incremental to Boston Gas as a result of the mergers and, therefore, rightfully belonged in the rates charged to Boston Gas's customers (id. at 3, citing D.T.E. 03-40, at 221-224). The Company, therefore, asserts that there has been no over-collection of gas acquisition costs since November 2003 (id.).

The Company states that gas acquisition costs represent operations and maintenance ("O&M") expenses, the recovery of which is determined in a base rate proceeding (id. at 4). The Company notes that, although gas acquisition costs are recovered through the CGAC,[18] rather than base rates, these costs are fixed at test-year levels in a rate case and are not updated each year to reflect the current level of expenses (id.).[19] The Company states that as a result of

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18 In Boston Gas Company, D.P.U. 93-60 (1993), the Department approved the company's proposal to collect through the CGAC the test year level of the administrative costs of gas supply acquisition (Account 813), costs that were previously collected through the base rates. Id. at 268, 281.

19 The Company notes that the O&M expenses for Colonial and Essex were last reviewed and approved for recovery in rates in 1993 and 1996, respectively (Company Reply Brief, at 4).

the merger approvals, the O&M expenses on the Colonial and Essex systems are frozen at levels set in their last base rate proceedings (id.). The Company states that pursuant to the terms of the merger orders, the recovery of these expenses will not be modified until a base rate proceeding occurs following the expiration of the rate freezes (id., citing: D.T.E. 98-27, at 66-69 (1998); D.T.E. 98-128, at 85 (1999)).

The Company asserts that the Attorney General's claim of double recovery of gas acquisition costs seeks only to re-litigate the Department's incremental cost determination in D.T.E. 03-40 and ignores the "interrelated rulings" of the Department in the merger cases, D.T.E. 98-27 and D.T.E. 98-128 (id. at, 5, 9). The Company claims that these rulings allowed the Company: (1) to reduce O&M expenses, including gas acquisition costs, without modification of rates until the next base rate proceeding; (2) to provide gas acquisition and planning services to the Colonial and Essex systems through KeySpan Services, which stands in place of Boston Gas; and (3) to charge Boston Gas customers for the total costs incurred by Boston Gas, through KeySpan Services, unless incremental amounts are incurred to meet the needs of Colonial and Essex (id. at 9).

In addition, the Company argues that the Attorney General ignores KeySpan's offer to maintain its current treatment of gas acquisition costs by setting up a separate adjustment factor similar to the one proposed for bad debt expense (id. at 4, citing Exh. DTE-1-42). The Company claims that given such a suggested separate factor, no change in the current treatment of gas acquisition costs would result from the Department's approval of the consolidated GAF (id. at 4, 9).

2. Analysis and Findings

The record shows that Colonial's gas acquisition costs, approved in its last base rate proceeding, are being recovered through both its base rates and the CGAC (Exh. AG-1-10).[20] Essex's gas acquisition costs, approved in its last base rate proceeding, are all being recovered through its base rates (Exh. AG-1- 9).[21] As stated above, Boston Gas recovers its gas acquisition costs through its CGAC. D.P.U. 93-60, at 268, 281 (1993). These gas acquisition costs, which form part of a company's O&M expenses, are test year costs determined during a base rate proceeding and therefore remain fixed until the company's next rate case.

In D.T.E. 98-27 (1988), the Department allowed Eastern Enterprises ("Eastern") to retain the cost savings resulting from the acquisition during the ten-year Essex rate plan. Id. at 66; see D.T.E. 03-40, at 212-213. After the acquisition, Boston Gas provided the needed corporate and administrative functions, which include gas acquisition, for Essex. To ensure that Boston Gas customers would not subsidize Essex customers during the ten-year Essex rate plan, and still allow Eastern the opportunity to recover merger cost savings, the Department determined that Essex would only be assigned incremental costs that Boston Gas incurs in providing corporate and administrative services to Essex. D.T.E. 98-27, at 5; see D.T.E. 03-40, at 213. Similarly, in D.T.E. 98-128, the Department allowed Eastern to

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[20] Colonial's Lowell and Cape Cod Divisions recover through their base rates gas acquisition costs of $278,523 and $204,504, respectively (Exh. AG-1-10). The same amounts, $278,523 and $204,504, are being recovered through the CGAC of Lowell and Cape Cod Divisions, respectively (Exh. AG-1-10).

[21] The amount of gas acquisition costs could not be determined because D.P.U. 96-70, in which Essex's current base rates were approved, was settled (Exh. AG-1-9).

retain the cost savings resulting from the acquisition and approved the same cost allocation principle used to account for Boston Gas's corporate and administrative costs incurred for Colonial. Id. at 85-86, 88-89; see D.T.E. 03-40, at 213.

In D.T.E. 03-40, KeySpan's gas acquisition cost in 2002 for its New England service territory was $1,034,180 (Exh. AG-1-16). This cost was allocated to Boston Gas, Colonial, and Energy North according to allocators approved by the SEC resulting in $704,671 allocated to Boston Gas, $191,527 to Colonial, and $137,982 to Energy North (id.).[22] In D.T.E. 03-40, the Company reallocated the $191,527, previously allocated to Colonial, to Boston Gas consistent with the incremental accounting mechanism approved in D.T.E. 98-128, resulting in a total amount of $896,198 ($1,034,180 - $137,982) in gas acquisition costs allocated to Boston Gas, $483,947 of which is recovered through its CGAC and $412,251 is recovered through its base rates (id.).

In 2000, when KeySpan acquired Eastern, KeySpan Services took over the responsibility for corporate and administrative functions, including gas acquisition, planning, and dispatching functions, formerly provided by Boston Gas to Colonial and Essex following the mergers in D.T.E. 98-27 and D.T.E. 98-128. D.T.E. 03-40, at 214. As indicated above, the 2002 test year level of gas acquisition costs allocated to Boston Gas do not include incremental costs, where incremental costs were defined "as those costs that Boston Gas would not have incurred except for the need to serve Essex and Colonial." D.T.E. 98-27, at 4-5;

[22] No gas acquisition cost was specifically allocated to Essex, because at the time of the merger it was anticipated that Essex would be merged into Boston Gas and would no longer exist as a separate corporate entity (RR-DTE-1).

D.T.E. 98-128, at 88-89; D.T.E. 03-40, at 213, n.94. In D.T.E. 03-40, the Department found that "KeySpan's acquisition of Eastern Enterprises did not create a fundamental alteration to the Department's decision in D.T.E. 98-27-A or D.T.E. 98-128 . . . but rather served only to shift the means by which the required cost allocation would be developed from Boston Gas to KeySpan Services." Id. at 222. The Department reaffirms this finding and accordingly finds that the rates approved in D.T.E. 03-40, effective November 1, 2003, do not over-recover or double-collect gas acquisition costs for Colonial and Essex.

In D.T.E. 03-40, the Department noted that if Colonial and Essex seek an increase in rates pursuant to G.L. c. 164, § 94, prior to the end of Boston Gas's performance-based rate plan, "there is a possibility that Boston Gas ratepayers would be subsidizing Colonial and Essex ratepayers because of the cost allocation approach prescribed by D.T.E. 98-27-A and D.T.E. 98-128." Id. at 224. By proposing a consolidated CGAC that recovers gas acquisition costs, currently being recovered through the base rates and the CGAC, the Company has raised a similar concern of possible cross-subsidization among ratepayers of Boston Gas, Colonial and Essex. In fact, allowing a consolidated approach to the recovery of gas acquisition costs would result in double recovery of a portion of those costs from customers of Colonial and Essex, because Colonial and Essex would continue to recover a fixed amount of gas acquisition costs their respective base rates. Accordingly, the Department denies the Company's proposal to consolidate the CGAC recovery of gas acquisition costs.

The Company, however, indicated that it does not object to maintaining its current treatment of gas acquisition costs as a separate cost item, similar to the Company's proposed treatment of bad debt expense (Exh. DTE-1-42). The Company has provided sample schedules showing a proposed CGAC filing and a gas cost reconciliation filing with the gas acquisition costs shown as a separate cost item for each company (RR-DTE-4). Consistent with this Order, the Department directs the Company to maintain the current treatment of gas acquisition costs and calculate separate GAFs applicable to each company similar to the Company's proposed treatment of bad debt.

Consistent with the Department's approach to the recovery of gas acquisition costs in D.T.E. 93-60 and to avoid the complications from the disparate treatment of these costs, the Department directs KeySpan to move the recovery of gas acquisition costs from base rates to the CGAC in the next base rate cases filed by Colonial and Essex.

B. Gas Cost Savings

1. Positions of the Parties

a. Attorney General

The Attorney General argues that the consolidation of the GAFs will result in burner-tip price increases that will harm Colonial and Essex customers by denying them savings promised in the merger cases D.T.E. 98-27 and D.T.E. 98-128 (Attorney General Brief at 8). The Attorney General states that in both cases, customer benefits were quantified into two categories: ten-year base rate freezes and "burner-tip" gas cost savings (id. at 6). The Attorney General states the Colonial and Essex customers were promised gas cost savings in return for foregoing possible base rate reductions related to merger savings in cost categories recovered through base rates, during both the period of the rate freeze and the remaining 30 years that the acquisition premium would continue to be amortized (id. at 7). The Attorney General concludes, however, that since the consolidation of the GAFs will immediately result in burner-tip price increases for Colonial and Essex customers, the terms of the merger agreement would be violated and the proposal should therefore be rejected (id. at 8).

The Attorney General contends that the Company's failure to quantify merger savings sufficient to allow the recovery of additional merger costs is further grounds for Department rejection of the proposal (id.). The Attorney General notes that the Company currently books all gas acquisition costs to the accounts of Boston Gas, and that these costs are recovered from Boston Gas customers through base rates and the CGAC (id. at 9). The Attorney General contends that under the Company's proposal, the CGAC portion of these costs will be recovered from the customers of Boston Gas, Colonial and Essex, while each customer will also continue to pay gas acquisition costs included in the base rates of Essex and Colonial (id.). The Attorney General contends that this mechanism creates an over-recovery of gas acquisition costs, which increases the ability of Colonial and Essex to offset merger costs during the base rate freeze period (id.).

The Attorney General states that when a company seeks recovery of costs directly related to a merger, the Department requires the company to demonstrate merger-related savings (id. at 8). The Attorney General asserts that in the immediate case, the Company is responsible for proving that the merger related costs Essex and Colonial customers will be paying are offset by sufficient merger savings (id. at 9-10). The Attorney General claims the

Company has not tracked or analyzed any gas cost savings promised in the merger petitions, nor has it provided any quantitative analysis of merger savings (id. at 10). The Attorney General concludes that because the Company cannot demonstrate that Colonial and Essex customers are recovering merger savings at a level equal to or greater than the additional costs KeySpan seeks to recover, the Department should reject the proposal (id.).

b. The Company

The Company asserts that the Attorney General: (1) ignores the significant cost savings received by Colonial and Essex customers since the mergers and (2) misrepresents both the joint petitioners' proposals and the Department's findings in the merger cases as to "estimated" savings (Company Reply Brief at 10).

The Company contends that both Colonial and Essex customers have received significant gas cost savings as a result of the mergers, and none of these savings were required in order for the joint petitioners to have met the Department's merger-approval standard or to recover merger costs under that standard (id.). The Company asserts that all estimated annual savings were achieved or exceeded on both the Colonial and Essex systems, but, since the mergers, load growth was experienced that was not anticipated in the merger projections (id. at 4). The Company explains that this load growth is being served through the integrated portfolio and that the consolidated GAF would effectively charge Colonial and Essex for the cost of the incremental capacity that they need to meet post-merger load growth (id. at 10-11). The Company concludes that the cost of this "incremental capacity" is offset by merger savings such that, in the aggregate, customers are still paying less than they would have in the absence of the mergers (id. at 11).

The Company further notes that the Attorney General's interpretations of the Department's findings on gas cost savings in the merger cases are incorrect given that the Department applied a "no net harm" standard in both the Colonial and Essex merger cases (id. at 12). The Company contends that under this standard a merger could move forward without any cost savings as long as there was no request to recover merger-related costs through rates (id.).

The Company argues that gas cost savings were not "promised" but instead were "estimated," as specifically noted by the Department (id. at 13). The Company contends that there is no basis for the Attorney General's statement that Colonial and Essex customers were "…promised gas cost savings in return for foregoing possible base rate reductions related to merger savings in cost categories recovered through base rates during both the period of the rate freeze and the remaining 30 years that the acquisition premium would continue to be amortized" (id. at 13). The Company argues that no such statement or concept is outlined in the Department's merger orders and that the orders instead indicate that estimated gas cost savings were essentially "extra" benefits and entirely independent of the base rate freeze and amortization and recovery of the acquisition premiums (id.).

The Company concludes that Colonial and Essex customers have received significant benefits to date and will continue to receive benefits on a going-forward basis under the consolidated GAF (id.).

The Company argues that the Attorney General's rationale regarding the double collection of gas acquisition costs exhibits three fundamental flaws (id. at 14). The Company first states that the Department has previously determined that the amounts charged to Boston Gas for gas acquisition costs beginning November 2003 are the costs that Boston Gas would incur for those activities even in the absence of the mergers (id., citing D.T.E. 03-40). The Company further claims that the Department's findings in D.T.E. 03-40 indicate that the amounts collected in Boston Gas rates are not incremental to Boston Gas, and therefore, are not properly charged to Colonial and Essex under the merger orders (id.). The Company also claims that gas acquisition costs are an O&M expense, the recovery of which was locked into Colonial and Essex rates for the rate-freeze period in the merger proceedings (id. at 14-15). The Company also contends that were the Department to approve the Company's proposal to consolidate the GAF, no change would occur in the amount of gas acquisition costs being recovered by the Company through Colonial and Essex rates since the time of the mergers (id. at 15).

The Company concludes that the validity of the Attorney General's arguments in this area were already refuted by the Company's response to the Attorney General's double collection of gas acquisition costs and that such an argument could only be designed to create confusion and delay (id. at 14).

2. Analysis and Findings

The Department approved the mergers for Colonial and Essex based on an evaluation and balancing of benefits and costs. Eastern-Essex Acquisition, D.T.E. 98-27, at 66-69

(1998); Eastern-Colonial Acquisition, D.T.E. 98-128, at 104-106 (1999). Some of those benefits included projected savings for ten-year rate freezes. D.T.E. 98-27, at 6, 21 (projected savings of $33 million for Essex); D.T.E. 98-128, at 11 (projected savings of $127.6 million for Colonial). Also, the burner-tip savings identified in the merger orders for Colonial and Essex were estimates of savings and did not represent guaranteed savings. In the Department's order approving the merger of Eastern and Essex, the Department stated that "the $2.35 million per year in gas cost savings from the Rate Plan are estimated and that the magnitude of this value would vary from year to year." D.T.E. 98-27, at 26 . In the Department's order approving the merger of Eastern and Colonial, the Department stated "that the $37 million in aggregate gas-related savings is projected over the term of the rate freeze and the actual savings may vary year-to-year." D.T.E. 98-128, at 72.

Furthermore, the record in this case shows that Colonial and Essex customers have received gas cost savings since the mergers and will continue to realize gas cost savings. In particular, Colonial customers have recognized demand cost reductions in the GAF of approximately $4.5 million per year over a four-year period, as compared to stand-alone costs, for a total of approximately $18 million in savings (Exhs. KED/EDA -1, at 21-22; KED/EDA-6(c). Colonial customers will continue to receive approximately $2.46 million per year in gas cost savings as compared to stand-alone costs (Exh. KED/EDA-1, at 21, Col. E). Essex customers have recognized demand cost reductions in the GAF of approximately $4.25 million per year over a six-year period, as compared to stand-alone costs, for a total of approximately $25.5 million in savings (Exhs. KED/EDA -1, at 21-22; KED/EDA-6(b)).

Essex customers will continue to receive approximately $360,000 per year in gas cost savings as compared to stand-alone costs (Exh. KED/EDA-1, at 21, Col. E).

Finally, the Attorney General's issue regarding the Company's ability to offset additional merger costs is addressed by the Department's requirement in Section V.A.2., above, where the Department (i) finds that there would be double recovery of gas acquisition costs in the Company's proposal and (ii) directs the Company to maintain the current treatment of gas acquisition costs and calculate separate GAFs applicable to each company. With this treatment of gas acquisition costs there is no recovery of additional merger costs.

C. Cash Working Capital Allowance

1. Positions of the Parties

a. Attorney General

The Attorney General argues that the Company's proposal increases the cash working capital allowance costs without providing sufficient supporting documentation (Attorney General Brief at 10). The Attorney General contends that the proposal not only incorporates changes to all components of the allowance without any supporting study or analysis, but it is not based on any method previously approved by the Department (id. at 12). The Attorney General explains that each company currently has a different cash working capital allowance factor based on the cost of capital approved in each company's last base rate case and different methods of determining the net lag (id. at 11). The Attorney General notes that the net lag used by Essex is 14.5 days, while Colonial uses 15.3 days and Boston Gas uses 39.7 days (id.). The Attorney General then states that, in this filing, the Company proposes to use the

9.08 percent cost of capital approved by the Department in D.T.E. 03-40 for Boston Gas Company (as compared to the 10.67 percent or 10.64 percent rates utilized by Essex and Colonial, respectively), and to compute net lag days based on new data for the companies (id.). The Attorney General contends that although the Company proposes to use the new data to determine the number of days between customer billing and collection, it also plans to base the other components of the net lag calculation, the days from receipt of service to meter read, days from meter read to billing and the expense payment lag, on Boston Gas data (id.). The Attorney General argues that despite the lower cost of capital, the proposal ultimately results in significant increases in costs to Essex and Colonial customers due to the doubling of cost flowing through the GAF (id. at 12). The Attorney General concludes that until KeySpan can supply a lead/lag study or another acceptable method of determining consolidated working capital requirements, the Department should reject the proposal and require the companies to continue to calculate their requirements and allowances for the GAF separately using the Department-approved method (id.).

b. The Company

The Company argues that the Attorney General is confused about the operation of Boston Gas's GAF purchased gas working capital calculation (Company Reply Brief at 15). The Company explains that the purchased gas working capital calculation is recalculated with each Boston Gas GAF filing, and that this methodology was approved by the Department more than ten years ago and is not changed as a result of the proposal in this case (id.). The

Company claims only to implement the same methodology with regards to Colonial and Essex, consistent with prior Department directives (id. at 15-16).

The Company further contends that Boston Gas has been using the same method to calculate its purchased gas working capital allowance since the Department approved its revised CGAC tariff recalculating the lead/lag based upon actual data in D.P.U. 93-60 (id. at 16). The Company explains that since both Essex and Colonial have already utilized this method, the Department's method for calculating purchased gas working capital allowance will not be changed by consolidating the GAF (id.).

The Company also states that KeySpan performed a purchased gas lead/lag study, as shown in Exhibit DTE 1-43, and that the Company will submit an updated lead/lag study at the time of its next GAF filing that will represent the actual lag days based upon actual CGAC data (id. at 17).

2. Analysis and Findings

In its day-to-day operations, an LDC requires working capital to pay for its O&M expenses and purchased gas expenses because of the time lag between the LDC's payment for such expenses and the customer's payment to the LDC for service.[23] Bay State Gas Company, D.P.U. 92-111, at 72 (1992). Working capital is provided either through funds generated internally by the LDC (i.e., retained earnings) or through short-term borrowing. Id.

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23 A separate working capital allowance is calculated regarding a company's distribution O&M, or non-gas costs, which is reimbursed by adding a working capital component to a company's base rate computation. Boston Gas Company, D.P.U. 93-60, at 47-48 (1993). KeySpan's non-gas O&M working capital allowance is not at issue in this case.

Department precedent entitles an LDC to be reimbursed for the costs associated with the use of its own funds and for the interest expense it incurs for borrowing. Id., citing Western Massachusetts Electric Company, D.P.U. 87-260, at 22-23 (1988). This reimbursement is accomplished by adding a working capital component to the company's GAF. See, e.g., The Berkshire Gas Company, D.P.U. 90-121, at 234-237 (1990).

Typically, an LDC calculates its purchased gas working capital allowance using a lead/lag study to derive the number of days between when the LDC pays its supplier for gas (lead days), and when its customers pay the LDC for that gas (lag days). D.P.U. 92-111, at 73-74. The purchased gas revenue lag factor (i.e., the number of days between the customer's receipt of gas service and the LDC's collection of the monies for that gas) is calculated for firm and interruptible customers based on the following four component periods: (1) receipt of gas service to meter reading; (2) meter reading to billing; (3) billing to collection; and (4) collection to receipt of available funds. Fitchburg Gas and Electric Light Company, D.T.E. 02-24/25, at 45 (2002). Both lead days and lag days are weighted average figures based on the weighted average of the number of days and the level of corresponding expense or revenue. D.P.U. 92-111, at 74-75.

The Department agrees with the Attorney General that KeySpan should continue to calculate separately the purchased gas working capital allowance for Boston Gas, Colonial, and Essex. KeySpan has proposed to use a new, standardized working capital factor (equity and debt) to be applied to gas purchases on a system-wide basis (Exh. KED/EDA-1, at 9). The Company would use the weighted cost of capital and weighted cost of debt approved for

Boston Gas in D.T.E. 03-40 (id.). KeySpan also proposed to base the calculation of the working capital factor on a net lag period that represents the combined (average) for Boston Gas, Colonial and Essex (Exh. DTE-1-43 (Att.)). These types of changes should be taken up in a base rate proceeding and not in the context of a rate consolidation or standardization proceeding. A change in a company's method for calculating the working capital allowance is approved by the Department in a base rate proceeding. See, e.g., Colonial Gas Company, D.P.U. 93-78-A at 4, 5 (1993); The Berkshire Gas Company, D.P.U. 90-121, at 234-236 (1990); Boston Gas Company, D.P.U. 88-67, Phase I at 40-43 (1988). Furthermore, although a company collects its gas working capital costs through the CGAC rather than through base rates, a company must present an updated calculation of purchased gas working capital costs as a part of a base rate proceeding. D.T.E. 02-24/25, at 44; D.P.U. 92-111, at 73.

Additionally, the record indicates that the net impact of (1) standardizing the period used to calculate the working capital factor for the three companies (from November 2002 through April 2003), (2) increasing the net lag period for Colonial from 24.38 days to 35.20 days and for Essex from 27.52 days to 35.20 days, and (3) using Boston Gas's lower cost of capital of 9.08 percent (versus 10.24 percent for Colonial and 10.67 percent for Essex) is an increase in the working capital allowance of $975,000 for Colonial and $308,000 for Essex (RR-DTE-2).[24] For Boston Gas the net impact is a decrease in the purchased gas

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24 The Company stated that by standardizing the period used to calculate the working capital factor for the three companies to conform to that for Boston Gas (from November 2002 through April 2003), the net lag days for Colonial increased from 15.31 days to 24.38 days (RR-DTE-2). For Essex, the net lag days increased from (continued...)

working capital allowance of $1,179,000 (Exh. DTE 1-43; RR-DTE-2). In terms of bill impacts, the proposed consolidation of the working capital factor will result in a decrease of $0.21 per month for Boston Gas customers and an increase of $0.56 and $0.59 per month for Colonial and Essex customers, respectively (RR-DTE-2). This evidence shows that the costs and benefits of the consolidation of the purchased gas working capital allowance are not fairly distributed among the customers of the three companies.

Accordingly, the Department denies the Company's proposal for a standardized purchased gas working capital allowance factor and directs KeySpan to calculate that factor separately for Boston Gas, Colonial,[25] and Essex, and not on a combined or consolidated basis, similar to the Company's proposed treatment of bad debt.

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24 (…continued)
14.53 days to 27.52 days (id.). According to KeySpan, the standardization alone increased the working capital allowance for Colonial customers by $496,000 and for Essex customers by $209,000 (RR-DTE-2). On the other hand, the lower cost of capital of 9.08 percent decreased the purchased gas working capital allowance for Colonial customers by $113,000 and for Essex customers by $24,000 (id.).

25 In D.P.U.93-78-A, the Department approved Colonial's proposal to recalculate its gas lag days using actual CGAC data. Id. at 4-5. Colonial has failed to implement this method. The Department hereby directs Colonial to implement this method of calculating the lag-day component of the purchased gas working capital allowance in its next CGAC filing.

D. Tariff Language

1. Positions of the Parties

a. Attorney General

The Attorney General contends that the Company's CGAC tariff does not clearly state which specific costs are to be included in the GAF, and, therefore, should be amended (Attorney General Brief at 12-13). Specifically, the Attorney General claims that a comprehensive set of definitions is lacking for the following GAF cost components: (1) gas acquisition planning and dispatch expenses; (2) reconciliation adjustment factors; (3) carrying costs; (4) interim gas adjustment factor; (5) cash working capital allowance; (6) capacity release; (7) margin sharing; (8) downstream assets; (9) non core; and (10) marginal cost (id. at 13-14). The Attorney General adds that other definitions need to be expanded to allow interested parties to understand how the terms are used in the GAF calculation (id. at 14). The Attorney General states that he welcomes the opportunity to participate in a generic proceeding to revise model tariffs, and that the Department should not approve the Company's proposed tariffs in their current form (id. at 13-14).

b. The Company

The Company contends that the proposed tariffs are fully consistent with the CGAC and LDAC tariffs for all other companies (Company Reply Brief at 17). The Company argues that the proposed language has sufficed for many years and that the Attorney General did not raise these suggested language changes during the hearing (id.). The Company further contends that the implementation of these changes at this late date has the potential to delay the proceedings, and that the Department's approval of the proposed tariffs does not prevent the Department from making tariff changes at a future date (id.).

2. Analysis and Findings

KeySpan has proposed to standardize the language, presentation, and numbering of rate tariffs for the three companies (Exh. KED/AEL-1, at 19-20).[26] The proposed standardized format generally will be the format currently used by Boston Gas (id. at 20). In moving to a standardized format, KeySpan has not proposed any substantive changes to the availability clauses or rate structures (id.). KeySpan also has proposed to consolidate the Terms and Conditions for the three companies, using the Boston Gas Terms and Conditions as a starting point (id. at 20-21). Provisions unique to Essex and Colonial have been retained in their respective Terms and Conditions (id. at 21). In reviewing the Company's proposal, we find that the standardization of formats and consolidation of the Terms and Conditions can provide administrative efficiency for the Company and aid in customer understanding of the tariffs. Accordingly, the Department approves KeySpan's proposal to standardize the format of its rate schedules and its proposal to consolidate the Terms and Conditions.

In reviewing the Company's filing, the Department notes that the basic definitions contained in the consolidated CGAC and LDAC tariffs are consistent with the definitions contained in each of the three company's currently approved tariffs. Those definitions are

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[26] This standardization is contained in tariffs M.D.T.E. Nos. 101 through 114 (Boston Gas), M.D.T.E. Nos. 201 through 213 (Essex), M.D.T.E. Nos. 301 through 313 (Colonial - Lowell Division), and M.D.T.E. Nos. 401 through 414 (Colonial - Cape Cod Division).

sufficiently workable to allow for implementation of the tariffs and for the calculations of the GAF and LDAF. Therefore, the Department does not require any changes or additions in the definitions for the Company's CGAC or LDAC tariffs, except as provided herein.

Regarding the initiation of a generic proceeding to create new, model tariffs, the Department does not find that such initiative is necessary at this time. We do not find that the definitions contained in LDCs' CGACs and LDACs have caused problems in calculating their respective GAFs and LDAFs. Therefore, the Department rejects the Attorney General's recommendations to open a generic proceeding to create model tariffs.

E. Pension/PBOP Reconciliation Adjustment Factor

1. Positions of the Parties

a. Attorney General

The Attorney General claims that there are two errors in the proposed tariffs for Pension/PBOP Reconciliation Adjustment Factor ("PRAF") (Attorney General Brief at 14). The Attorney General states that the errors in the Company's formula include: (1) amortization of the unamortized PBOP transition obligations over a three-year period instead of a ten-year period and (2) the provision for carrying charges twice on the Unamortized Reconciliation Deferral Pension amount (id. at 14-15). The Attorney General states that the Department required the Company to recover its PBOP costs, including the ten-year amortization of the transition obligation, through base rates without carrying charges (id. at 15, citing D.T.E. 03-40). The Attorney General notes, however, that in Boston Gas Company, D.T.E. 03-40-A (2004), the Department shifted these costs to the PRAF (id.

at 15-16). The Attorney General asserts that the Department only changed the manner in which these costs are recovered and did not order the Company to modify or rescind the amounts of the PBOP costs to be recovered in any year (id. at 16). The Attorney General contends that in the proposed LDAC tariff, the Company alters the PBOP transition obligation from a ten-year amortization period to a three-year amortization period, at an annual cost of over $10 million a year to customers (id.).

The Attorney General also argues that the Company's formula allows KeySpan to recover the carrying charges on unamortized reconciliation deferred balances twice (id. at 17). The Attorney General states that the PRAF formula provides carrying charges on two components, the URD and APBOP. The Attorney General notes that URD is defined as, "the Unamortized Reconciliation Deferral Pension is the amount of the Pension Reconciliation Deferral not yet included in distribution rates," while the APBOP is defined as, "the Unamortized Reconciliation Deferral not yet included in distribution rates" (id.). The Attorney General continues by stating that the term "Reconciliation Deferral" appearing in the definition of APBOP is defined as, "…the difference between (1) the total pension and PBOP expense amounts included in Boston Gas Company's base rates; and (2) the total expense amounts booked by Boston Gas Company in the Prior Year in accordance with the requirements of FAS 87 and FAS 106" (id.). The Attorney General argues that because the APBOP includes both the pension and PBOP deferred amounts and the URD includes pension deferrals, the Company is seeking to double-recover carrying charges on the pension deferrals (id.). The Attorney General concludes that the double-recovery can be eliminated by simply removing the URD term from the formula.

The Attorney General continues by stating that the Company has not provided interest on the past period reconciliation amount as other utilities with pension adjustment filings have (id. at 18). The Attorney General notes that both NSTAR and Fitchburg Gas and Electric Light Company have incorporated an interest component on the past period reconciliation amounts to be debited/credited to the PRAF at the prime rate computed in accordance with 220 C.M.R. § 6.08 (2) (id.). The Attorney General argues that including interest on over/under recoveries is necessary to prevent the Company from unjustly profiting from over-collections from its customers (id.).

The Attorney General concludes that the Company must: (1) change the amortization of the transition obligation from three to ten years; (2) remove the URD term in its entirety from the formula to ensure that there is no double-recovery of carrying charges on pension reconciliation deferral balances; and (3) add an interest provision on the past period reconciliation amounts (id.).

b. The Company

The Company asserts that, in practice, the Company is amortizing the PBOP transition obligation over a ten-year period through base rates, and has calculated carrying charges on unamortized pension and unamortized PBOP reconciliation deferrals as directed by the Department in D.T.E. 03-40 (Company Reply Brief at 18). The Company concedes, however, that the language submitted in Exhibit KED/AEL-8 referencing the terms "APDA" and "APBOP" is ambiguous and has filed a redlined version of Exhibit KED/AEL-8 to clarify the definitions (id.).

2. Analysis and Findings

In D.T.E. 03-40, the Department continued the recovery in base rates of Boston Gas's PBOP transition obligation over the remaining ten-year amortization period without carrying charges. Id. at 312-313. In D.T.E. 03-40A, in a response to Boston Gas's motion for clarification/reconsideration, the Department allowed the recovery of the Boston Gas's PBOP expenses, excluding the amortization of its PBOP transition obligation, in its PRAF. Id. at 7. The Attorney General argues that the Company's proposed PRAF formula is an attempt by Boston Gas to accelerate the recovery of its transition obligation from ten years to three years (Attorney General Brief at 16). In response to these concerns and acknowledging the possible ambiguity in its PRAF formula, Boston Gas filed a revised LDAC tariff, in redlined format, with corrections to the PRAF formula and corresponding definitions (Exh. KED/AEL-8 (revised)). In this revised exhibit, the Company has changed the definition of (i) the reconciliation adjustment for each year, (ii) the unamortized reconciliation deferral pension, and (iii) the unamortized reconciliation deferral PBOP (id. at 12-13). Upon review of the Company's revised tariff, the Department finds that the corrected PRAF formula and revised corresponding definitions properly provide for the amortization of the Company's PBOP transition obligation over the remaining ten-year period. Therefore, we accept the revised LDAC tariff as provided in Exhibit KED/AEL-8 (revised), subject to modification herein.

Regarding the issue of the application of carrying charges to the Company's reconciliation amounts, the Company's proposed PRAF provides for carrying charges on two components: (1) the unamortized pension reconciliation deferrals not yet included in base rates ("URD") and (2) the unamortized PBOP reconciliation deferrals not yet included in base rates ("APBOP"). The Attorney General maintains that the Company's proposed formula results in a double-recovery of carrying charges on unamortized pension deferrals (Attorney General Brief at 17). The Attorney General's argument is based upon the position that both the URD and APBOP components include unamortized pension deferrals (id.). In its Exhibit KED/AEL-8 (revised) the Company has sought to clarify the application of carrying charges in its PRAF formula through the changes in definitions identified above, and by renaming the unamortized PBOP reconciliation deferrals not yet included in base rates as "$URDPBOP_t$", deleting APBOP (id. at 12-13). Upon review of the Company's revised tariff, the Department finds that the corrected PRAF formula and revised corresponding definitions properly provide for the application of carrying charges to the unamortized pension and the unamortized PBOP reconciliation deferrals, as directed by the Department in D.T.E. 03-40. Accordingly, we find that the Company's proposed PRAF formula, as revised, does not provide for the double-recovery of carrying charges on unamortized pension deferrals.

On the issue of the calculation of interest on past reconciliation amounts, the Department directed the Company to "apply the prime rate on its reconciliation of forecast recovery to actual recovery consistent with 220 C.M.R. § 6.08(2)." D.T.E. 03-40, at 314. We agree with the Attorney General that the Company's PRAF formula does not provide for this required interest calculation. Therefore, we direct the Company to revise its PRAF formula and corresponding definition to provide for the calculation of interest, at the prime rate consistent with 220 C.M.R. § 6.02, on the past period reconciliation amount (“$PPRA_t$”).[27]

F. Mitigation Plan for Essex

1. Analysis and Findings

As stated above, in response to a request by the Department, KeySpan submitted a plan to phase in the increase resulting from the consolidation of the GAF for Essex customers over a two-year period (RR-DTE-5). Under this plan, KeySpan would first calculate the difference between the consolidated GAF and the GAF that would become effective for Essex customers during the 2004-2005 peak period using Essex-only gas costs (id.). The Company would then divide the difference by two, and recover one-half of the amount from Essex customers, and the other half from Boston Gas and Colonial customers via their 2004-05 peak GAFs (id.). Beginning with the 2005-06 peak GAF, KeySpan would calculate the Essex GAF based solely on the proposed GAF consolidation to bring Essex customers even with Boston Gas and Colonial customers (id.). The Department requested consideration of a mitigation plan for Essex because of the bill impacts for Essex customers that would result from a consolidated GAF. For example, for high-load factor commercial and industrial Essex customers (G-51,

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[27] In revising the formula for the Pension and Post-Retirements Benefits Other than Pension Reconciliation Adjustment Factor within the LDAF, the Department directs the Company to utilize, as much as practicable, the same definitions and terminology as are included in the NSTAR “Pension/PBOP Adjustment Mechanism” (see, e.g., Boston Edison Company, M.D.T.E. No. 109). The use of standardized terms across similar tariffs will contribute to an ease of review by the Department and an ease of understanding by interested parties.

G-52, and G-53), the implementation of the consolidated GAF and elimination of class-specific GAFs would result in bill impacts ranging from an increase of approximately 14 to 27 percent in the peak season and an increase of approximately four to seven percent in the off-peak season (Exh. KED/AEL-1, at 14).

As a result of the increases in bills that would be seen by Essex customers as a consequence of the GAF consolidation, the Department finds it necessary to examine KeySpan's initial filing in light of our rate structure goal of rate continuity.[28] Under the goal of rate continuity, rate structure changes should be made in a predictable and gradual manner that allows consumers reasonable time to adjust their consumption patterns in response to a change in rate structure. D.T.E. 03-40, at 366. Based on our review of the bill impacts for Essex customers, we find that KeySpan's consolidated GAF as initially filed violates the Department's rate goal of continuity. Therefore, the Department finds it appropriate to require a plan to mitigate the bill impacts for Essex customers.

KeySpan's mitigation plan would implement the increase to Essex customers over a two-year period. The Department finds that this period of time is appropriate to adjust the impact, considering the fact that the GAF is intended to recover gas costs on a current basis. The other component of KeySpan's mitigation plan provides for the recovery of a portion of the mitigated amount from Boston Gas and Colonial customers. Because of rate continuity considerations, we do not favor abrupt movement to a consolidated GAF for Essex customers

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28 Utility rate structures must be efficient, simple, and ensure continuity of rates, fairness between rate classes, and corporate earnings stability. D.T.E. 03-40, at 365.

(i.e., from December 31, 2004 to January 1, 2005[29]). We do, however, favor the notion that cost responsibility should follow cost incurrence. See NSTAR Electric, D.T.E. 03-121, at 46 (2004). To balance these two objectives, we approve the mitigation plan proposed by KeySpan. That is, KeySpan shall move Essex customers to a consolidated GAF over two peak periods (i.e., 2004-2005 and 2005-2006). During the 2004-2005 peak period, the Company shall increase the Essex GAF by 50 percent of the difference between the amount of an Essex consolidated GAF and the current GAF for Essex. The remaining 50 percent shall be recovered through the 2004-2005 peak period consolidated GAF for Boston Gas and Colonial. Beginning with the 2005-2006 peak period GAFs (beginning November 1, 2005) and thereafter, the Essex, Colonial and Boston Gas respective GAFs would be calculated at the consolidated GAF.

VI. CONCLUSION

The Department finds that KeySpan's overall proposal of consolidation is appropriately designed to accurately reflect the manner in which its gas supply resources are managed to serve all customers. That is, the price charged to customers for gas service would capture the benefits associated with the consolidated resource portfolio currently utilized by KeySpan. Subject to the Department's changes identified above, the Department finds that KeySpan's consolidated GAF is consistent with the public interest and will result in just and reasonable rates for ratepayers. Also, subject to the Department's changes identified above, the

29 Based on the timing of this Order, the Department expects that KeySpan will implement the consolidated GAF beginning January 1, 2005.

Department finds that KeySpan's consolidated LDAF is consistent with the public interest and will result in just and reasonable rates for ratepayers. Further, the Department finds that KeySpan's consolidated Terms and Conditions and standardized rate tariffs are consistent with the public interest.

Therefore, KeySpan's consolidation proposal is approved subject to the following changes, as more fully stated above: maintain the current treatment of gas acquisition costs in the calculation of separate GAFs applicable to Boston Gas, Colonial, and Essex;[30] calculate the purchased gas working capital allowance factor separately as part of the GAFs for Boston Gas, Colonial, and Essex; revise the LDAF formula and corresponding definitions to provide for interest on the past period reconciliation amount; and institute a two-year mitigation plan, as specified herein, to implement the consolidated GAF for Essex customers.

VII. ORDER

Accordingly, after due notice, hearing and consideration, it is

ORDERED: That tariffs M.D.T.E. Nos. 101 through 104, 201 through 213, 301 through 313, and 401 through 414 filed by KeySpan Energy Delivery New England be and hereby are APPROVED; and it is

FURTHER ORDERED: That tariff M.D.T.E. No. 3 (Distribution Terms and Conditions) filed by KeySpan Energy Delivery New England be and hereby is APPROVED; and it is

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30 KeySpan's proposal already provides for maintaining the current treatment of bad debt expense in the calculation of separate GAFs for the three companies (Exh. KED/AEL-1, at 10).

FURTHER ORDERED: That tariff M.D.T.E. No 1 (Cost of Gas Adjustment Clause) filed by KeySpan Energy Delivery New England be and hereby is DISALLOWED; and it is

FURTHER ORDERED: That tariff M.D.T.E. No 2 (Local Distribution Adjustment Clause) filed by KeySpan Energy Delivery New England be and hereby is DISALLOWED; and it is

FURTHER ORDERED: That KeySpan Energy Delivery New England shall comply with all directives contained in this Order.

By Order of the Department,

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Paul G. Afonso, Chairman

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James Connelly, Commissioner

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W. Robert Keating, Commissioner

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Eugene J. Sullivan, Jr., Commissioner

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Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Act of 1971).